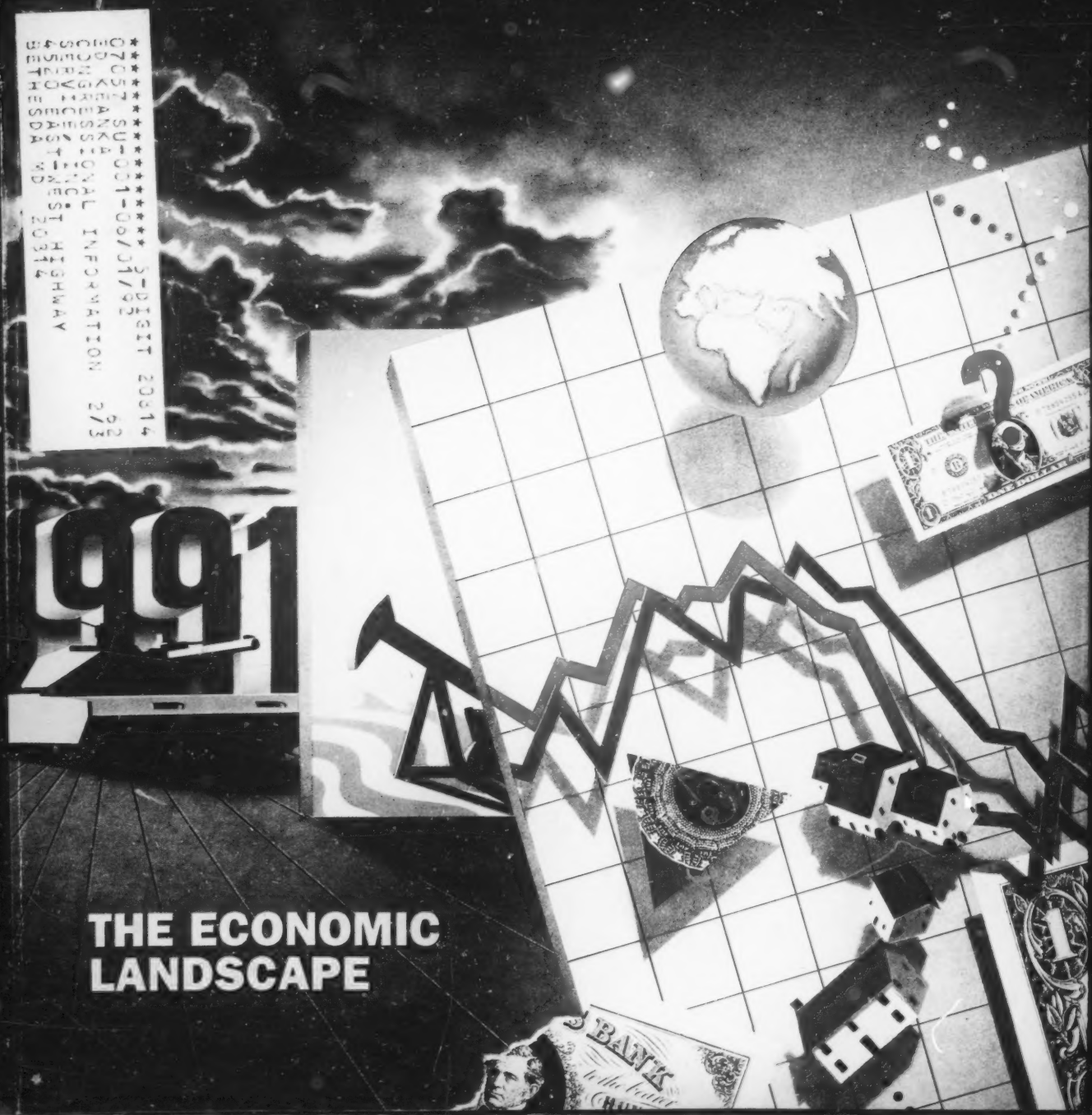
MORTGAGE BANKING

JANUARY 1991

THE MAGAZINE OF REAL ESTATE FINANCE



THE ECONOMIC LANDSCAPE

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Future Visions

As our cover suggests, we are hunkering down for a year when military events and oil seem likely to hold the capital markets hostage. For lenders, the volatility in the market could promise a real roller coaster ride in 1991. For borrowers, the year might be one when the art of deciding when to lock rates is finally perfected or at least studied very seriously.

Because Saddam Hussein's next move is difficult to forecast, we asked our forecasters to stick to economic fundamentals. Our cover report scopes out the near-term outlook for the U.S. economy. And surprisingly enough, the news is not that grim for an economy entering recession. Our eyes into the future—MBA Chief Economist Lyle E. Gramley—says by this year's second half, economic activity and single-family construction are expected to turn up again. The article makes the case as to why this recession is likely to be neither prolonged or severe, as recessions go. But Gramley does predict that: "Some banks, already in a weakened condition, will not survive the recession, and some insurance companies may also fail."

So, the forecast for 1991 is not for a roaring good year. But it could be worse. The long-term prospects for the housing market are also included within the covers of this issue, in case the short-term ones leave you less than satisfied. Fannie Mae's Chief Economist David Berson goes on the record with the prediction that "30-year fixed-rate mortgages should average a bit above 9 percent in the coming decade." Since everyone knows economists are hesitant to forecast very far out into the future, we applaud the daring of this author to go for broke.

Finally, another offering this month tries to put last year's housing legislation in some perspective. Congress remains very much caught up with the chilling memory of the thrift crisis and its costly aftermath. We offer you the thoughts of some key policymakers who had to make tough decisions on the FHA program in the wake of the painful episode with the thrifts. It may shed some light on why Congress passed reforms that many say erred on the side of overkill.

Janet Reilley Hewitt
Editor in Chief

COMING IN FEBRUARY

Servicing managers face some tough issues as the recession arrives and delinquencies pick up. The next issue will focus on ways to prevent foreclosures, as well as geographic markets where delinquencies are on the rise. We will also offer tips for boosting servicing productivity.

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ECONOMIC PROSPECTS FOR 1991

The current recession will be mild and relatively short, unless of course, the Gulf crisis erupts. By the second half of 1991, homebuilding and economic growth should be rebounding.

Lyle E. Gramley

Writing about economic prospects is much more fun when the outlook is bright and cheery. But after seven good years and one rather lean one, the economy's prolonged growth since late 1982 has come to an end: 1991 will mark the first recession year since 1982 and the ninth recession of the postwar period.

Forecasting in the midst of an economic downturn is always a chancy business because the dynamics of a decline are hard to predict. This year, the usual difficulties are exacerbated by a series of events and problems that might convert a mild decline into a severe and prolonged one. The Middle East crisis has weakened consumer and business confidence and eroded real income through its impact on oil prices. Many financial institutions are weaker than at any time since the 1930s, and real estate markets in some areas are being battered in ways that have shaken local residents.

The economy of the United States, nonetheless, still has solid footings, and we believe the current recession will be relatively mild in both depth and duration. By the second half of 1991, economic activity and single-family housing construction are expected to turn up again, albeit with less than the usual vigor that is characteristic of earlier postwar recovery periods.

The case for a mild recession

The case for a mild recession rests on three pillars. The first is that absent a shooting war (and maybe even with one, although that is much less certain), oil prices will come down from the average level prevailing since August 2, 1990, to a range of $20 to $25 a barrel. The loss to world oil supplies of Iraqi and Kuwaiti production since August has largely been offset by the increased output of Saudi Arabia and other countries, so that world demand and supply for crude oil are in reasonably good balance. (Today's oil prices still reflect market fears of a disruption of supplies should a shooting war erupt.) Such a drop in crude oil prices—particularly if accompanied by an end to the Middle East crisis—would have a tonic effect on the economy. Consumer spending power would improve; inflation would abate, and consumer and business confidence would turn up again. The crisis in the Persian Gulf is not the only reason for the current recession, but it is a major contributor. Removing that growth impediment would be of major benefit to our overall economic health.

The second pillar on which the case for a mild recession rests is the state of inventories. On average during previous postwar recessions, roughly half of the decline in real GNP was accounted for by a sizable drop in inventory investment. Investment in business stocks will decline in this recession, too, but by modest proportions, because inventories have remained lean relative to sales. Growth in final sales began to slow noticeably early in 1989, as it often does late in an economic expansion. For a time, inventory-sales ratios rose a bit, but that prompted strong action by both manufacturing and trade firms to trim excess stocks. By March 1990, the ratio of inventories to sales for all manufacturing and trade firms had dropped a little below its level 15 months earlier. This remarkable restraint by businesses—aided by sophisticated inventory control systems—will diminish substantially the degree of downward pressure on the economy coming from the need to reduce inventories further as the recession proceeds.

Growing exports provide the third reason for expecting the U.S. economy to pull out of recession before too

ILLUSTRATION BY DICKRAN PALULIAN

Make no mistake about this: lenders have stopped shoving money down the throats of borrowers, as they did throughout much of the 1980s.

much damage occurs. Since the summer of 1986, U.S. net exports of goods and services have risen roughly $100 billion in constant dollar terms—about 2 percent of real GNP. The rate of increase was particularly rapid in 1987 and 1988, when the benefits of the dollar's fall in value in exchange markets from early 1985 to early 1988 were most strongly felt. Since then, the rise in net exports has been more subdued, but it is clearly not over. Growth abroad—in Asia as well as in Western Europe—is much stronger than in the U.S. Moreover, the dollar's international value has declined substantially further since mid-1989, thus greatly enhancing our competitive position in world markets. Indeed, measured in foreign currencies, prices of U.S. merchandise exports today are at about the same level as in late 1980. Prospects for a further increase in U.S. net exports during 1991 seem quite good, and that will help keep the economy from going into a free fall.

Based on these considerations, the MBA economics department forecast anticipates an upturn in the U.S. economy in the second half of this year—but a modest recovery. If inventory investment does not decline much, there is little room for the usual early recovery rebound. That factor alone would keep the recovery of moderate dimensions. Dampening the recovery still more will be the problems of financial fragility and weakness in real estate markets mentioned earlier. Some observers believe that these problems will keep the economy in a prolonged recession. Maybe, but we don't think so.

The credit crunch

The economy entered the current recession confronting a problem never before encountered in earlier postwar downturns: a financial system with lots of weak spots. The issue is not whether the fragility of financial markets will shape the contours of economic performance in 1991; that we know for sure. The question is whether financial fragility will doom the U.S. economy to a deep and prolonged recession.

A recession always magnifies the difficulties faced by lenders, because more loans go sour as business sales and profits decline. Some banks, already in a weakened condition, will not survive the recession, and some insurance companies may also fail. Lending standards all across the nation, and particularly in the Northeast, have already been tightened significantly, and will tighten still further as the recession proceeds. Will access to credit by private borrowers be so severely choked off as to prevent the economy's recovery altogether?

Confident answers to that question are impossible, but insights into how the financial system might respond can be gleaned from financial data available to date. Restraints on lending standards to private borrowers have been intensifying since mid-1989, spreading from residential builders and commercial property developers to businesses more generally, and widening from the Northeast to affect virtually every geographic region of the country. Nonetheless, at this writing, credit to the private sector continues to flow, albeit more slowly. Despite severe restrictions on bank lending to finance new multifamily and commercial construction, total real estate loans at commercial banks are still moving up. Despite a decline in commercial and industrial loans at all commercial banks since August 1990, total business short-term borrowing has risen further, as many businesses have met their short-term credit needs by issuing commercial paper in larger quantities.

These results reflect the fact that participants in financial markets over the past two decades have learned to cope with problems by innovating. A combination of earlier regulatory restraints and fierce competition have strongly encouraged innovative behavior by borrowers and lenders alike, and the lessons learned will stand them in good stead during 1991. Moreover, the aggregate supply of funds available for investment this year will increase—bank deposits will rise, pension fund assets will grow, and insurance company reserves for investment will increase. A larger-than-normal portion of the new funds will be invested in Treasury securities, as lenders seek greater safety. But with yield spreads between private securities and Treasury issues widening, lending to the private sector will remain attractive to strong financial institutions (of which there are many) who will search out and lend to businesses with a good bottom line and strong management, and individuals with the wherewithal to buy a home or a new car.

Make no mistake about this: lenders have stopped shoving money down the throats of borrowers, as they did throughout much of the 1980s. This will affect the ability of the U.S. economy to return to a strong economic growth rate once the recession is over. But we do not believe that credit shortages will become so severe as to prolong or deepen the recession unduly.

Real estate markets

Weakness in real estate markets also is thought to pose a threat to make the recession long and deep. Once again, it's possible, but we don't think it will happen.

There are two disaster areas within the general field of real estate: multifamily residential properties and commercial real estate—office buildings, shopping centers, hotels and motels. In both areas, activity (and vacancy rates) rose dramatically in the first half of the 1980s in response to federal tax laws that encouraged investment in buildings whose economic prospects were doubtful. When tax reform came along in 1986, multifamily housing starts began to fall, and are now only

Single-family housing starts will bottom out this spring, with the trough not far below current levels, and that activity will improve moderately in the second half when the overall economy shows signs of recovery.

one-third of their early 1986 level. The reaction of commercial construction to tax reform was delayed, however, as money continued to pour into the industry—particularly from failing savings and loan associations desperate for front-end fees. Both of these sectors of the real estate industry are now being hammered by severe constraints on the availability of credit.

Construction in both of these areas will decline further in 1991, exercising a drag on GNP growth throughout the year. This would be a major problem for the overall economy if activity in these two areas were a sizable part of the total economy; in fact, together they comprise less than 1½ percent of real GNP.

Other areas of nonresidential construction are doing reasonably well. Industrial construction in constant dollars rose 9 percent over the past year; construction carried on by state and local governments rose a similar amount. Construction of private nonresidential buildings other than industrial and commercial structures—such as hospitals and religious and educational buildings—rose 3 percent over the year. In all of these areas, which comprise around 2½ percent of real GNP, activity is expected to continue rising in 1991.

Single-family residential construction, by far the largest single element of the overall construction industry, is a separate case. Mortgage bankers are all well aware that single-family home sales and housing starts have been declining for more than four years. The rate of descent, however, does not begin to compare with the abrupt drop that occurred in the crunches of 1979-80, or 1981-82 (see Chart 1). Unfavorable demographic factors, persistently high real mortgage interest rates and rising unemployment during the current recession will continue to drag down housing activity in the months ahead, but the chance that housing starts will plunge as they did a decade ago is remote. Indeed, we believe that single-family housing starts will bottom out this spring, with the trough not far below current levels, and that activity will improve moderately in the second half when the overall economy shows signs of recovery.

The MBA housing forecast for 1991, shown in Table 1, can hardly be regarded as wildly optimistic. On average, we expect housing starts to be about 10 percent lower this year than last; both existing and new single-family home sales will be down. Mortgage loan originations on one- to four-family residences will probably be below $350 billion, the lowest level since 1985. Mortgage bankers are expected to capture a bit more than one-fourth of the market—a lower share than in 1990, but about the same as in 1989.

With the slower rate of growth of the underlying demographic demand for shelter, a substantially better year for the single-family housing market, and for residential mortgage lenders, would seem to rest heavily on the prospects for a substantial decline in mortgage interest rates, especially rates on fixed-rate mortgages. Continued high long-term interest rates abroad will probably prevent a major decline in U.S. long-term interest rates, unless and until the inflation rate in the U.S. begins to show signs of fundamental improvement. Rising unemployment this year—to a range of 6¾ to 7 percent by the second half—will increase the chances of a significant breakthrough on the inflation front. But it may well be 1992 before the Federal Reserve's efforts to curb inflation begin to bear ample fruit.

Lyle E. Gramley is chief economist for the Mortgage Bankers Association of America in Washington, D.C.

CHART 1

Single-Family Housing Starts

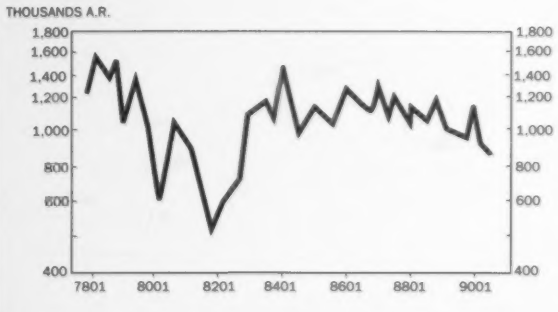


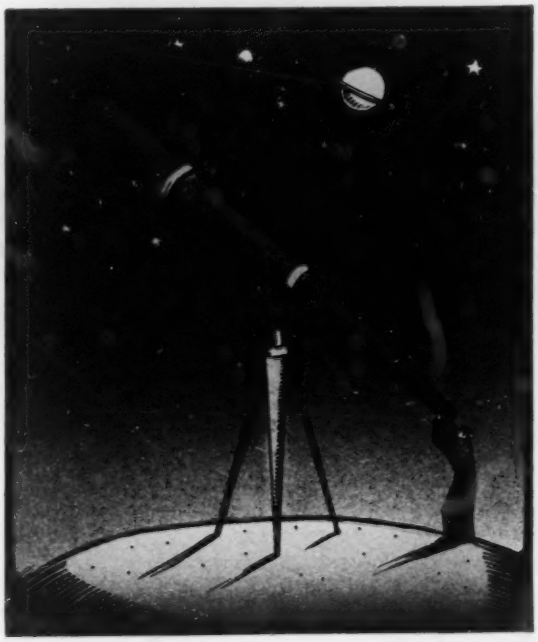
TABLE 1

MBA Housing Forecast

	1990	1991
Housing Starts: (000)		
Total	1,210	1,080
1-4 Family	950	880
Multifamily	260	200
Home Sales: (000)		
New Single-Family	540	520
Existing	3,250	3,200
Mortgage Loan Originations, 1-4 Family, Billions		
Total	$355	$345
Mortgage Bankers	100	90
Share	28%	26%

A Longer Perspective

Long-term interest rates should decline by about 350 basis points in the 1990s compared to their average during the last decade. That's the outlook by Fannie Mae's chief economist.



David W. Berson

The outlook for 1991 is dependent in large part on events in the Middle East. Because economists have no comparative advantage in forecasting military or political events, the outlook carries with it a higher degree of uncertainty than usual. But in general, Fannie Mae's outlook for the economy and the housing market in 1991 is similar to the forecast presented by Lyle Gramley, chief economist of the Mortgage Bankers Association.

The long-term outlook is yet another matter that carries its own degree of uncertainty. We will attempt to sort out some of the factors that will shape the economy in the years ahead.

The near-term outlook

We have made the assumption that the conflict in the Middle East will be resolved in the first quarter of 1991, either through negotiations or a quick and successful war. The impact on the U.S. economy should be similar in either case, although even a successful war carries risks for the short-term production and distribution of crude oil from the entire Gulf region. If events in the Middle East actually unfold in this manner, then oil prices should fall sharply during the first half of next year, sliding to $21-$23 per barrel by mid-year. This should also push the overall rate of inflation down abruptly from current levels.

The economy is likely to begin this year in the same fashion that it ended the last one—in a mild recession. The combination of lower inflation and reduced borrowing demands will allow long-term interest rates to decline. In addition, with the economy contracting, the Federal Reserve should continue easing monetary policy, pushing short-term rates down. The decline in rates will be constrained, however, for several reasons.

First, high real interest rates abroad and the continuing need for foreign financing of our budget deficit will keep domestic interest rates from falling quickly or far. Second, despite lower overall inflation in the first half of 1991, a mild recession is not likely to create enough slack in the economy to bring the "core" rate of inflation down appreciably—and that will help to prop up long-term rates and keep the Fed from easing dramatically. Finally, unless the economy is weaker than we expect, the Fed will probably not ease aggressively for fear that the dollar would drop precipitously. The weak economy should allow rates to fall through mid-year, with long-term rates declining by about 50 basis points from late-1990 levels—putting 30-year fixed-

ILLUSTRATION BY RANDY LYNUS

rate mortgages around 9.50 percent—and short-term rates dropping by a bit more.

The primary reason for the current mild recession—the collapse of consumer confidence stemming from the Iraqi invasion of Kuwait—should begin to be reversed with a resolution of that conflict. Although lower mortgage rates will help the housing market, the current slow housing market has not been caused by excessively high mortgage rates. As a result, a significant rise in home sales and construction is not likely to occur unless potential buyers are more confident about their future employment and income prospects—which is unlikely to occur without a favorable resolution to the crisis in the Middle East.

This rise in consumer sentiment, combined with lower interest rates, is expected to allow the housing market to begin recovering by the second quarter. Home sales should recover first—with new home sales climbing to about a 585,000 annual rate by the fourth quarter and existing home sales going up to 3.42 million units. For the year as a whole, home sales should be close to their 1990 levels. Builders are likely to lag the increase in sales, however, particularly for multifamily structures. Difficulties in financing multifamily projects, combined with still-high vacancy rates, will keep multifamily construction in the dumps for at least the year ahead.

Single-family construction is expected to begin to pick up after the rise in new home sales becomes more pronounced, but difficulties in obtaining loans for acquisition, development and construction—as well as builder caution—are likely to keep single-family starts at relatively low levels. As a result, total housing starts for 1991 should be down by about 6 percent from 1990, although we expect them to get steadily stronger as the year progresses.

The economy is likely to begin this year in the same fashion that it ended the last one—in a mild recession.

Fannie Mae's forecast of mortgage originations for 1991 is somewhat more optimistic than MBA's, with home sales and price projections that are slightly stronger. The drop in mortgage rates during the first half of 1991 also should allow an increase in refinancing activity throughout much of the year. As a result, we expect one- to four-family mortgage originations to climb by about 3 percent over 1990's level—which should end up slightly below the level of 1989.

The long-term outlook

In determining the outlook for housing and mortgage markets during the next decade, more than a simple forecast of economic and housing demand is required. Over the long run, demographics and productivity growth largely control the housing market—combined with public policy changes affecting tax policy and land use. During the next decade, two events should dominate demographic changes in the United States: a slowdown in population growth and the passing of the "baby boom" generation—those born between 1946 and 1964—into middle age. According to the Census Bureau, the total population of the U.S. is projected to increase by only 0.7 percent annually in the next decade, compared with growth rates of 1.1 percent in the 1970s and 1.0 percent between 1980 and 1989.

Significant changes in the composition of the population are expected to accompany this slowdown in population growth. The proportion of adults in the 25 to 34 age group swelled from 12.3 percent in 1970 to 17.9 percent in 1988. In the 1990s, much of this demographic bulge will move into the 35 to 44 age bracket. By 2000, all of the baby boomers will be above the age of 35. As a result, the share of the total population between the ages of 35 to 44 will rise steadily from 13.3 percent in 1985 to 16.6 percent in the year 2000.

Household growth is also expected to slow in the 1990s. This will result not only from slower population growth, but also from smaller increases in headship rates, that is, the number of heads of households in the country. On balance, headship rates in the next decade are projected to increase modestly for the baby boom generation (age 35 to 54), with smaller increases projected for the 25 to 34 and 65-and-over age groups. The headship rate for the 55 to 64 age group is expected to show no change, while the rate for the under-25 age group is expected to show a small decline.

Combined with the changing age structure of the population, this projection of headship rates produces an annual average increase in households of about 1.2 million (see Table 1). By contrast, household formation surged to a record annual average of more than 1.7 million in the 1970s as the baby boom generation began to reach adulthood. Household growth slowed in the 1980s, although it remained strong by historical standards. Still, household growth is estimated to have slowed by more in the 1980s than it should in the 1990s.

For analyzing housing demand, it can be useful to group households by traditional first-time homebuyers (heads of households under 35 years), moveup households (35 to 54 years), and older households (55 years and above). Between 1970 and 1980, the number of first-time households increased sharply, and their share of total households grew to 31 percent. Between 1980 and 1990, the share of moveup households will have increased as the leading edge of the baby boom enters this age group. The share of moveup households should grow even more dramatically by the year 2000 (see Table 2).

Clearly, the moveup households will be increasing their demand for housing—given the state of the economy—over the 1990s. During the same

TABLE 1

Households and Household Growth
(thousands)

	Total Households	Average Annual Increase Over Previous Decade
1960	52,799	925
1970	63,403	1,060
1980	80,776	1,737
1990	94,562	1,379
2000	106,612	1,205

TABLE 2

Composition of Households
(thousands)

	1970	1980	1990	2000
First-time (under 35)	16,053	25,073	26,057	22,759
	(25%)	(31%)	(28%)	(21%)
Moveup (35 to 54)	24,026	26,634	35,700	47,100
	(38%)	(33%)	(37%)	(44%)
Older (over 55)	23,324	29,069	32,805	36,753
	(37%)	(36%)	(35%)	(35%)

Note: Percentages represent shares of the total population in each year.

TABLE 3

Economic Figures: History and Projections

	1950-1960	1960-1970	1970-1980	1980-1990	1990-2000
Annualized Percent Change in:					
Real GNP	3.3%	3.8%	2.8%	2.9%	2.7%
GNP Deflator	2.6%	3.1%	7.4%	4.4%	4.0%
Productivity	2.1%	2.4%	1.1%	1.4%	1.6%
Annual Averages:					
10-Year Treasury	3.4%	4.9%	7.9%	10.3%	7.0%
Mortgage Rate	—	6.7%	9.2%	11.5%	9.3%
Unemployment Rate	4.6%	4.8%	6.3%	7.1%	4.9%
Employment Growth	901	1,671	1,953	2,058	1,870

TABLE 4

Home Sales and Starts
(thousands)

	New Sales	Total Starts	Existing Sales
1970-1980	661	1,750	2,885
1980-1990	618	1,500	3,070
1990-2000	575	1,250	3,550

TABLE 5

Changes in Median Home Prices

	New Homes		Existing Homes	
	Nominal	Real	Nominal	Real
1970-1980	10.7%	3.3%	10.5%	3.2%
1980-1990	6.5%	2.1%	4.5%	0.1%
1980-1985	5.5%	0.2%	4.0%	−1.3%
1985-1990	7.5%	4.0%	5.0%	1.4%
1990-2000	6.6%	2.5%	3.8%	−3.2%

TABLE 6

Single-Family Mortgage Originations, Annual Averages
($ billions)

	Purchase Originations	Refinancings	Total
1970-1980	101.1	12.6	113.6
1980-1990	217.5	68.3	285.8
1990-2000	408.4	72.1	480.5

period, however, the first-time households will be actually shrinking; lessening the demand for starter homes. How will the moveup buyers be able to sell their homes to first-time buyers if the population of first-time buyers is shrinking?

Part of the answer to this should come from pent-up demand for starter homes coming from baby boomers. Homeownership rates fell consistently from 1980 to 1985, and have remained nearly unchanged since then. It has been the under-40 age group that has suffered the biggest decline in homeownership rates over this period, primarily for affordability reasons. If homeownership rates for this group increase in the 1990s—as they move into age brackets that typically have higher homeownership rates, as their incomes increase from moving up the career ladder and as real mortgage rates decline and real home price appreciation slows (see the following)—then much of the decline in first-time buyer demand among younger households may be offset.

For example, if the 1976 homeownership rates for the 25 to 45 age groups had prevailed in 1988, there would have been an additional 2.6 million homeowners. The increase would still be large—1.0 million—if the base year chosen was 1983, by which time homeownership rates for younger households had fallen significantly.

Although the economy may be described well in the short-term by its demand characteristics, over the longer-term it is the economy's supply side that largely determines such things as growth and inflation. The supply side of the U.S. economy is determined primarily by the inputs to the production process—land, labor and capital—as well as the efficiency with which those inputs are used, measured by productivity.

Fannie Mae's projections of population and household growth suggest that growth of the labor force is likely to slow in the 1990s, implying that employment growth will also slow. Unfortunately, this slowing of employment growth will be compounded by continued slow productivity gains as a result of historically low levels of net business fixed-investment in the 1980s and an educational system that has slipped, compared with other nations. This slow productivity growth will

mean that real GNP growth in the coming decade will be below average (see Table 3).

Despite relatively low economic and productivity growth, the rate of inflation should be somewhat slower in the 1990s than during the past 10 years. Much of the inflation in the 1970s and early 1980s was due to Federal Reserve reaction to supply shocks—with an expansionary monetary policy initially monetizing the rise in energy prices. The current oil shock indicates that the Fed will not respond to rising energy prices as it did in the past, keeping the basic thrust of monetary policy an anti-inflationary one. In addition, the federal budget deficit should decline in the 1990s, particularly as a share of output. Furthermore, increased international competition, as U.S. trade expands, will make it more difficult with time for domestic firms to increase prices beyond the rate of productivity growth.

Lower inflation should bring a reduction in inflation expectations and a decline in real interest rates. Combined with the drop in expected inflation should be lower federal government borrowing needs, as the budget deficit declines as a share of GNP—especially with rising social security surpluses. In addition, modest increases in personal savings as the U.S. population ages should help to reduce real interest rates. Taking all of these influences together, long-term interest rates should decline by about 350 basis points during the current decade compared with their average in the 1980s—bringing the rate on 10-year Treasuries down to about 7.0 percent, or about 125 basis points below current levels.

Mortgage rates should share in this drop, but to a somewhat lesser extent. Increased levels of mortgage and mortgage-backed security sales in the 1990s as a result of FIRREA will likely widen the spreads between mortgages and Treasuries from current levels—although this widening should not be substantial. As a result, 30-year fixed-rate mortgages should average a bit above 9.0 percent in the coming decade.

Primarily as a result of the decrease in net household formation, housing starts should decline in the 1990s compared with the 1980s. In addition, the absolute decline in younger households is expected to result in a shift away from both mobile homes and multifamily rental properties. Given the forecast of 1.2 million new households per year, new housing units of about 1.45 million per year will be needed. Since about 200,000 units of that need will be met by mobile homes, down from 250,000 in the 1980s, starts will yield about 1.25 million.

We expect one- to four-family mortgage originations to climb by about 3 percent over 1990's level—which should end up slightly below the level of 1989.

The split between single-family and multifamily starts will move more to favor single-family construction during the current decade given the decline in younger households—who typically rent—and the still-large inventory of vacant multifamily rental units. Taking this into account, multifamily starts of about 310,000 per year should occur in the 1990s, compared with annual averages of more than 600,000 in the 1970s and about 500,000 in the 1980s. The remainder of the needed housing units will be single-family, yielding a projection of average annual single-family starts of 940,000. That compares with almost 1.15 million single-family starts in the 1970s and about 1 million in the 1980s.

Because a portion of single-family home construction is contract built (and so is never counted as a home sale,) new home sales are less than starts. In the absence of any significant long-term variation in the 1980s average of new home sales, averaging just under 62 percent of single-family starts, the 1990s average should be similar. This would yield new home sales of about 575,000 for the current decade, compared with 618,000 in the 1980s and 661,000 in the 1970s. The ratio of moveup homes to starter homes will likely be much higher in the 1990s than in the 1980s as the baby boom cohort moves into middle age. This should result in an increase in the number of new homes sold to moveup buyers despite a drop in overall new home sales due to fewer first-time buyers.

Existing home sales depend most heavily on the number of households in the long run, with changes in economic growth and interest rates influencing year-to-year sales. Lower mortgage rates on average in the 1990s, as well as somewhat faster economic growth (coming primarily from no deep recessions such as 1981-82) should result in an increase in the resales-to-households ratio. The drop in younger households, however, should just about offset the impact of mortgage rates and economic growth. As a result, the ratio of existing home sales to households in the 1990s is expected to be about the same as in the 1980s—3.5 percent. This leads to a rising projection for existing home sales as the absolute number of households rises. For the 1990s as a whole, existing home sales should average about 3.55 million per year, compared with 3.07 million in the 1980s and 2.89 million in the 1970s (see Table 4).

Home prices over the coming decade will depend upon the relative demand and supply for homes, as well as changes in the mix of homes sold. The demand for housing depends upon the number of households, income growth, interest rates and consumer preferences. Slower income growth during the decade resulting from modest real GNP gains and rising income flows going abroad due to the accumulation of trade deficits in the 1980s and 1990s, as well as lower net household formation, should act to slow housing demand. On the other hand, lower real mortgage rates will add to housing demand by improving affordability. In addition, the demand for relatively more expensive trade-up homes will increase with an aging population.

The supply of housing is determined by an array of costs, including labor, materials, land and regulation. Since 1960, both labor and lumber costs have increased at about the same rate as the consumer price index, and

there is no reason to expect any change from this pattern in the 1990s. Land costs, however, are estimated to have risen about twice as fast as inflation. Slower demand for housing should reduce land price appreciation, although an increase in the demand for second-homes by an aging population may partially offset this. Regulatory costs involve building codes and standards, lot requirements, impact and transfer fees, zoning ordinances and other growth limits and land-use restrictions.

These regulatory costs give every indication of rising at an increasing rate in the 1990s. Areas of high population density, particularly where limits have been imposed on general real estate taxes, have already begun turning to taxes on new construction and transfer of ownership to offset infrastructure costs.

On balance, home prices should rise more slowly in this decade than in the last one. New home prices should continue to rise faster than inflation as a result of rising demand for trade-up homes and increasing supply costs for housing. Existing home sales, however, are likely to rise at about the rate of inflation, as supply cost increases will impact existing homes only with time as new homes in the 1990s become resales. In addition, the decline in younger households will slow demand. As a result, the gap between median prices of new and existing homes should continue to grow (see Table 5).

From these projections of the economy and the housing market, we can estimate the volume of single-family mortgage originations. Originations can be broken down into loans for home purchases, purchase originations and refinancings. The volume of purchase originations during the 1990s is based on the dollar volume of single-family home sales, which follows from the forecasts of home sales and prices just given. With mortgage rates in the 1990s not projected to reach the extreme levels of the early 1980s—and also not dropping as they did in the mid-1980s—refinancings can be expected to average about 15 percent of total originations, significantly less than the almost 24 percent level of the 1980s (see Table 6). Note that these figures are based on the old survey of mortgage originations by HUD. In January 1990, HUD changed its survey methodology in a way that has made the origination figures before 1990 not strictly comparable to the new figures. To get an estimate of the size of the change, 1990 originations are estimated to be about $412 billion using the new survey methodology—but only about $350 billion using the old methodology.

In conclusion, the housing market during the 1990s should be better than it will be in 1991. The mild recession that we are currently in, which we expect will last for about six months, will act to keep the housing market in its depressed state until the middle of this year. For the year as a whole, the housing market in 1991 will resemble 1990. For the decade as a whole, however, lower real interest rates, more affordable housing, and increased home buying by baby boomers should offset much of the impact of slower population growth and household formation. **MB**

David W. Berson is vice president and chief economist of Fannie Mae in Washington, D.C.

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VITAL STATISTICS

INTEREST RATES & YIELDS
1- TO 4-FAMILY MORTGAGES

	FHA OPINION SURVEY	FHFB			FNMA		FHLMC	
1990	FHA New Homes[1]	CONVENTIONAL[2] FRM	ARM	Median Cost of Funds SAIF Institutions	1-Yr. ARM	FRM Conv.	ARMs	FRMs
AUG	10.20%	10.33%	9.18%	7.66%	7.96%	10.00%	8.35%	10.10%
SEP	10.26	10.33	9.06	NA	7.96	10.07	8.28	10.18
OCT	10.24	10.37	9.03	NA	7.84	10.08	8.20	10.17
NOV	**NA**	**NA**	**NA**	**NA**	**7.60**	**9.87**	**8.08**	**9.90**

SELECTED SECURITIES

		PRIME COMMERCIAL PAPER	U.S. GOVERNMENT				
1990	FEDERAL FUNDS RATE	(3-Month)	6-Month	1-Year	3-Year	10-Year	A-Rated Utility
AUG	8.13%	7.88%	7.38%	7.78%	8.22%	8.75%	10.29%
SEP	8.20	7.96	7.32	7.76	8.27	8.89	10.28
OCT	8.11	7.98	7.16	7.55	8.07	8.72	10.23
NOV	**7.81**	**7.91**	**7.03**	**7.31**	**7.74**	**8.39**	**10.07**

CURRENT SECONDARY MARKET YIELDS

SPREADS
(Basis Points)

1990	GNMA[3]	FNMA[3]	FHLMC[3]	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
AUG	9.80%	9.75%	9.75%	105	100	100
SEP	9.86	9.79	9.73	97	90	84
OCT	9.84	9.80	9.69	112	108	97
NOV	**9.57**	**9.54**	**9.48**	**118**	**115**	**109**

SECONDARY MARKET ACTIVITY
(Dollars in Millions)

	FNMA				FHLMC*				GNMA	
	Portfolio		Mortgage-Backed Securities						Pass-Through Securities	
1990	Commitments**	Purchases	Out-Standing	Issued	Commitments To Sell	Commitments To Buy	Mortgages Purchased	PCs Issued	Applications	Issued
JUL	$2,215	$2,304	$268,052	$6,869	$4,507	$5,851	$4,527	$4,247	$8,553	$5,551
AUG	2,302	2,134	275,227	9,378	6,279	5,645	5,417	4,808	4,492	6,557
SEP	2,073	2,123	281,806	8,953	4,749	6,643	5,798	5,707	7,094	5,421
OCT	**1,849**	**2,077**	**287,674**	**8,078**	**NA**	**NA**	**NA**	**NA**	**5,748**	**5,346**
1989 TOTAL	27,409	22,518	---	69,764	85,408	86,263	78,589	73,518	62,000	57,323
1988 TOTAL	23,435	23,110	---	54,878	41,271	70,669	44,075	39,777	60,009	55,285
10 MONTH AVG. 1990	1,916	1,947	---	8,049	5,886	7,592	5,753	5,761	5,553	5,386
1989	2,238	1,716	---	5,091	6,409	6,660	6,037	5,645	4,753	4,617
1988	2,080	1,979	---	4,404	3,280	5,122	3,343	2,929	4,953	4,648

*FHLMC year to date averages are for nine months.
**Does not include standby commitments issued, but includes standby commitments converted.

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES

(Units in Thousands, Seasonally Adjusted Annual Rates)

	BY TYPE OF UNIT						BY REGION							
	HOUSING STARTS			BUILDING PERMITS			HOUSING STARTS				BUILDING PERMITS			
1990	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Northeast	Midwest	South	West	Northeast	Midwest	South	West
JUL	1,153	904	249	1,082	838	244	113	225	493	322	111	227	428	316
AUG	1,131	866	265	1,050	818	232	120	241	434	336	112	225	402	311
SEP	1,107	897	210	992	786	206	104	242	441	320	104	221	386	281
OCT	**1,041**	**885**	**156**	**925**	**754**	**171**	**144**	**236**	**395**	**266**	**115**	**198**	**358**	**254**
1989 TOTAL	1,376	1,059	318	1,338	999	340	179	266	536	396	179	252	505	402
1988 TOTAL	1,488	1,140	348	1,456	1,070	386	235	274	575	404	230	266	544	416
10 MONTH AVG. (SAAR)														
1990	1,241	975	266	1,160	885	275	138	267	488	348	132	258	437	334
1989	1,402	1,075	327	1,342	1,002	340	188	268	549	397	185	259	507	389
1988	1,477	1,134	343	1,442	1,061	381	246	266	567	399	238	261	538	407

HOME SALES

(Units in Thousands)

	EXISTING HOMES			NEW HOMES		
1990	Sold (SAAR)	Available for Sale	Months Supply At Current Sales Rate	Sold (SAAR)	Available for Sale	Months Supply At Current Sales Rate
JUL	3,330	2,570	9.3	541	351	7.9
AUG	3,500	2,720	9.3	530	345	8.0
SEP	3,170	2,590	9.8	509	339	8.3
OCT	**3,020**	**2,580**	**10.3**	**491**	**334**	**8.4**
1989 TOTAL	3,440	---	---	650	---	---
1988 TOTAL	3,584	---	---	676	---	---
10 MONTH AVG. (SAAR)						
1990	3,330	---	---	547	---	---
1989	3,518	---	---	653	---	---
1988	3,448	---	---	678	---	---

VALUE OF NEW PRIVATE CONSTRUCTION PUT IN PLACE

(Units in Billions of 1987 Dollars, Seasonally Adjusted Annual Rates)

	Total[5]	1-Unit	2+ Units	Nonresidential
JUL	$300.8	$100.0	$16.9	$99.0
AUG	293.0	97.6	16.9	94.1
SEP	289.1	95.2	16.7	93.0
OCT	**286.9**	**93.5**	**17.0**	**92.4**
1989 TOTAL	308.5	108.3	20.7	96.0
1988 TOTAL	314.4	112.0	21.4	93.5
10 MONTH AVG. (SAAR)				
1990	302.0	104.1	17.7	94.8
1989	310.9	109.3	21.0	96.4
1988	314.4	111.7	21.0	93.6

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED
By Type of Institution and By Type of Unit
(Dollars in Millions)

	1-4 UNITS					5+ UNITS					NONRESIDENTIAL				
	Total[3]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies	Total[3]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies	Total[3]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies
1990															
MAR	$35,273	$8,703	$12,700	$13,460	$29	$2,970	$557	$1,113	$1,014	$61	$19,167	$102	$804	$15,172	$2,978
APR	35,407	7,543	12,400	15,122	28	1,973	145	935	698	50	18,984	100	621	14,796	3,048
MAY	37,255	9,420	13,183	14,231	27	2,453	297	1,061	874	39	15,412	110	640	10,905	2,657
JUN	**39,247**	**9,714**	**14,028**	**15,063**	**29**	**2,938**	**209**	**1,149**	**682**	**182**	**16,429**	**105**	**684**	**12,303**	**3,097**
1989															
TOTAL	352,026	65,606	157,676	123,193	1,443	31,145	4,443	13,469	7,669	2,786	149,950	1,688	14,476	106,424	25,675
1988															
TOTAL	383,566	85,307	188,871	101,863	3,331	38,158	4,526	20,551	6,920	3,732	181,604	1,032	24,368	124,106	29,986
6 MONTH AVG.															
1990	35,717	9,175	12,245	13,869	65	2,826	459	987	865	210	16,946	128	704	12,695	3,039
1989	27,827	5,346	12,838	9,247	77	2,512	271	1,245	572	174	10,949	104	1,458	7,551	1,703
1988	30,100	6,952	14,239	8,375	187	2,793	304	1,569	515	245	15,148	50	2,037	10,829	2,006

MORTGAGE INSURANCE
(Units in Thousands, Dollars in Millions)

	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	TOTAL	FHA[8]	VA	PRIVATE	TOTAL		FHA		VA		PRIVATE	
					Units	Amount	Units	Amount	Units	Amount	Units	Amount
JUN	150	90	17	43	112	$9,010	64	$4,289	16	$1,309	32	$3,412
JUL	144	84	15	45	118	9,651	67	4,509	15	1,253	36	3,889
AUG	154	89	18	47	126	10,273	70	4,764	19	1,572	37	3,937
SEP	**119**	**68**	**14**	**37**	**109**	**8,827**	**64**	**4,319**	**14**	**1,180**	**31**	**3,328**
1989 TOTAL	1,687	990	194	503	1,274	95,956	726	45,893	183	12,946	365	37,117
1988 TOTAL	1,755	949	211	595	1,334	98,012	699	42,577	211	15,771	424	39,664
9 MONTH AVG.												
1990	144	86	17	41	114	8,993	66	4,386	17	1,337	31	3,270
1989	143	85	16	42	102	7,715	57	3,581	15	1,145	30	2,989
1988	153	84	17	52	112	8,187	59	3,544	17	1,298	36	3,345

NA—Not Available; SAAR—Seasonally Adjusted Annual Rate

[1]Secondary market gross yields. Numbers shown for each month are the average of yields from the first day of the month shown and the first day of the subsequent month.

[2]Effective rate on loans closed.

[3]Securities for 0- to 30-day delivery.

[4]In addition to the categories of private construction shown, the total also includes these categories: residential improvements, railroads, electric light and power, gas, telephone and telegraph, petroleum pipelines, and farm nonresidential.

[5]In addition to the categories shown, the total also includes private pension funds, private MBS conduits, state and local retirement funds, federal credit agencies, mortgage pools, and state and local investment agencies.

[7]Savings & Loans and Mutual Savings Banks.

[8]FHA applications received includes the Direct Endorsement Program.

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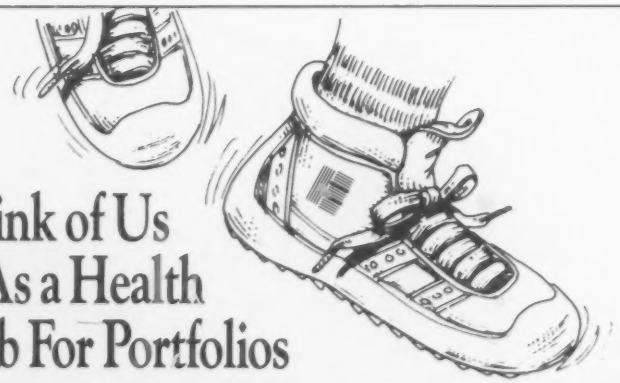

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